Low Incomes
Tax Reform
Group

A voice for the unrepresented

A manifesto for low income taxpayers

A large print version of this report is available from The Chartered Institute of Taxation upon request. Please write to the Low Incomes Tax Reform Group, The Chartered Institute of Taxation,1st Floor, Artillery House, 11-19 Artillery Row, London, SW1P 1RT.

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About the Low Incomes Tax Reform Group

The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes.

About the Chartered Institute of Taxation

The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

Foreword

Many people on a low income actually have quite complex tax affairs. Partly this is the inherent complexity of tax legislation, but it is also down to the way that the taxation system is administered. When things go wrong for this population, the consequences can be catastrophic from a financial point of view, leading to debt and the risk of significant health issues arising from the stress and anxiety caused.

This was the motivation behind the creation of the Low Incomes Tax Reform Group (LITRG) 17 years ago, and it remains as true as ever. LITRG was set up by the Chartered Institute of Taxation (CIOT) in 1998 to give a voice to these taxpayers, who usually cannot afford to pay for tax advice and must navigate the tax system alone, or with the help of volunteer advisers. LITRG brings together former and current tax professionals, including former 'big four' partners and ex-HM Revenue & Customs (HMRC) senior officials, alongside experts on tax and tax credits on our own staff. It also includes specialists from other organisations with an interest in this area – such as Tax Help for Older People, itself a spin-off from LITRG (though now a fully independent charity).

Central to our work is developing and putting forward our own ideas for improving the tax system for those we seek to represent. As we head towards a new Parliament we believe this is an opportune time to set out some proposals for improvements and changes to the taxation system that would benefit the low-paid and others whom we seek to represent. We do not take a position on how much tax people should pay, as that is a matter for an elected government.

We seek a system which operates in a way that everyone can navigate and which recognises that support may need to be tailored to individuals to enable them to comply. Consequently, some of these changes are geared towards helping groups who are particularly vulnerable or who have particular difficulties with the way in which the tax system operates. Others, such as some of our proposals for improving the PAYE system, would benefit much larger swathes of the population. While some of our proposals involve a change in legislation, others require only changes to guidance or procedures.

LITRG is grateful to ministers of successive governments, and to civil servants at all levels, for being willing to listen to – and occasionally act upon – our proposals in the past. For example, Finance Act 2014 completed a useful set of reforms we have argued for which will enable more disabled people to make use of tax-favoured trusts, and the 2014 Autumn Statement announced both the extension of the £2,000 employment allowance to elderly and disabled people who employ carers, and a limited tax simplification for carers who take a meal with their employers or stay overnight.

We hope that the next government, whatever its complexion, will take up the recommendations in this manifesto in the new Parliament. As always we stand ready to work with policy-makers of all kinds – and increasingly in the devolved bodies as well as Westminster – to assist them in making the tax system work better for low-income taxpayers.

Anthony Thomas

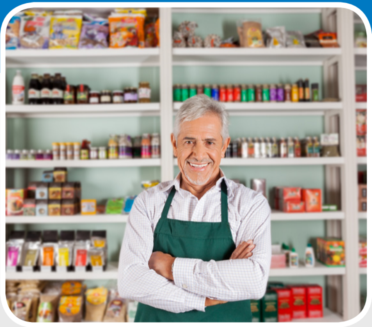
Chairman

Who needs help with the tax system?

Low income employees

While the PAYE system keeps tax relatively simple for most people with a single steady job, an increase in numbers of taxpayers with multiple employments, or moving between employments, has meant it has become harder to ensure that the right amount of tax is deducted from every pay packet each month. With the responsibility placed on taxpayers to check they are paying the right amount of tax it needs to be as simple as possible to do this.

Self-employed workers



Self-employed people are responsible for their own tax and National Insurance calculations and payments. This means navigating a complex world of profits, losses, expense deductions, capital allowance claims, business record checks and a set of rules for benefit and tax credit entitlement which are more tricky than those facing employees. Surveys regularly identify tax complexity as one of the main complaints of small business owners.

Agency workers

While most people are either employed or self-employed, a growing number of others find themselves in a grey area between the two, complicating their tax affairs still further. For example, agency workers might be employees in tax terms but ‘workers’ for other purposes such as entitlement to the National Minimum Wage. Some might receive in-work state benefits. Controversial ‘umbrella arrangements’ are sometimes set up by agencies to turn agency workers’ successive work locations into ‘temporary workplaces’ but HMRC have sought to challenge this, creating uncertainty and unanticipated tax bills.

Migrants

For those newly arrived in the UK, the tax system will need to be learned from scratch and language barriers may make misunderstandings more common. Any income earned in a home country may cause further tax issues. Complications also arise when people leave the UK.

Pensioners

Although many pensioners are 'asset rich', having paid off the mortgages on their homes, the incomes of pensioner households remain lower, on average, than those for the nation as a whole, as well as more complicated thanks to the variety of income sources involved. The state pension, other benefits, occupational pensions, personal pensions, income from savings and investments and ongoing earnings all contribute. Multiple sources of income tend to mean more frequent and more complicated interactions with the tax authorities. When a partner dies, it can be difficult, at a stressful time, to resolve the affairs of the deceased and of the bereaved survivor.

Disabled people and carers

The Government are encouraging independent living, giving people with disabilities more choice on how their needs are met. As a result more people are employing a personal assistant to provide personal care, with all the tax and National Insurance responsibilities that entails. Additionally, the interactions between state benefits and income tax are complex, and those on low incomes are often attracted to self-employment because of its flexibility to accommodate individual needs. Making systems flexible enough to cope with these needs is a real challenge.

Students

The majority of students work part-time to help finance their studies. Particular tax issues affect mature students, apprentices, volunteers and interns. Many students now come to the UK from overseas to study and UK-based students might study or work overseas for a period of time, resulting in complex interactions with the tax authorities in relation to country of residence.

Summary of Recommendations

1 Improve the PAYE system to bring greater clarity and accuracy for taxpayers and lower administrative costs

- Prioritise development of a unified Notice of Coding
- Issue statements to all taxpayers at the end of the tax year showing all benefits paid and whether or not they are taxable
- Review the possibility of the DWP operating PAYE on the state pension
- Provide a simpler mechanism for collecting small PAYE debts

2 Better communication and education by on tax matters by government

- Upgrade guidance provided on GOV.UK to make it clearer and more comprehensive.
- Improve communication and application of special relief
- Improve communication and guidance for tax credit claimants, especially where people stop being part of a couple
- Ensure that guidance around the new pensions regime includes adequate support on taxation issues
- Expand education of finance and tax within society, particularly in schools

3 Make paying tax as easy as possible for taxpayers with particular needs

- HMRC's Needs Extra Support service should be promoted, expanded and similar practice extended to other Government Departments
- Channels other than digital must be provided for citizens who require them
- Continue/increase support for the tax charities to enable them to help those who cannot afford tax representation
- Continue to seek opportunities to simplify the tax system for unrepresented taxpayers

4 Improve how the tax and benefits systems work together

- Consider accompanying future increases in the income tax personal allowance with equivalent changes to the work allowance within Universal Credit
- Interactions between taxation and benefits must be considered fully by the Scottish and UK Governments before any further devolution takes place
- Review treatment of the self-employed under Universal Credit

5 A tax system that recognises the distinctive challenges of self-employment and agency work

- More flexible tax payment arrangements for the self-employed
- A coherent and clear approach from government to the use of umbrella companies, bringing greater certainty for the low-paid

6 Ensure limits and thresholds keep up with the cost of living

- The rent-a-room relief should be doubled and index-linked in future

1 Improve the PAYE system to bring greater clarity and accuracy for taxpayers and lower administrative costs

The Pay As You Earn (PAYE) system collects tax and National Insurance contributions (NIC) in relation to employees' wages and salaries and pension incomes. Tax is deducted at source by the employer or pension provider and paid over to HMRC on the taxpayer's behalf. (Further background on PAYE may be found in Appendix 1.)

Many taxpayers now have multiple employments and/or self-employments during their working lives and consequently may start to receive various pensions at differing times from different payers. Ensuring that, as far as possible, taxpayers have the correct amounts of tax deducted from their employment and pension income is becoming increasingly difficult.

PAYE has seen great change in recent years. Behind the scenes, investment has been made in new information technology, allowing HMRC to centralise taxpayers' PAYE records and to automate end-of-year reconciliations to check whether tax has been correctly paid. Communication between the DWP and HMRC has also improved, but this is an area where further investment would make the system work more efficiently. More recently, PAYE has moved to 'real-time information', though that development has required a great deal of investment from employers as well as HMRC to bring it to fruition.

We are concerned that the same level of investment has not been made in keeping taxpayer communications up-to-date and focused on individuals' needs.

1A. HMRC should prioritise development of a unified Notice of Coding

Employers and pension providers need to be provided with a Notice of Coding instructing them of the amount of tax to be deducted from each individual's pay or pension. One copy of each Notice of Coding is sent to the employer, with a more detailed copy sent to the taxpayer. A taxpayer with three sources of PAYE income will receive three separate Notices of Coding – one for each employment or pension, but possibly at different times and in different envelopes. If HMRC decide that any change is necessary, further Notices of Coding may be issued over the course of the tax year. It can be difficult, therefore, for a taxpayer to see the overall picture and understand how their allowances are allocated.

Recently, HMRC have decided not to issue code numbers where the change is believed to make no difference to the taxpayer, because no tax is payable. This can make it difficult for the taxpayer to review their overall situation.

Benefits

- **Taxpayers and HMRC able to see at a glance how an individual's allowances are allocated, resulting in the correct amount of tax being collected in-year more often**
- **Fewer contacts to HMRC due to the public better understanding the tax system**
- **PAYE debt should be reduced**

Case Study 1
Carol

Carol was widowed in June 2013. Prior to her husband's death Carol's own tax situation was very simple – she received a reduced state pension and a small amount of investment income. Following her husband's death, she became entitled to an increased state pension and widow's pensions from the two schemes of which her late husband had been a member. She notified both HMRC and the Department for Work and Pensions (DWP) within a week of the death and was pleased that her state pension was quickly increased.

Over the months to April 2014 she received various coding notices from HMRC that she did not understand, but given that they knew her circumstances she was not concerned about this.

In July 2014 she received a P800 tax calculation that apparently summarised her income for the 2013/14 year and showed she owed tax of around £800. Carol was sure this was a mistake and queried the figures.

To her dismay, she was told that they were correct: incorrect coding notices had been the problem because her state pension was not properly included. She contacted the DWP to check the state pension figures: these were finally agreed after a delay of some eight weeks.

Carol decided to check her coding notices for 2014/15 and found they too were incorrect. She had them amended but anticipates having a further tax bill to pay in summer 2015 (or to have her PAYE code amended for a later tax year to collect the tax that was underpaid, therefore reducing her income).

These unexpected bills have upset Carol's budgeting process and she is having to economise now in a way she did not expect. Compared to others she is relatively fortunate in that she can at least afford to pay the tax owed.

1B. The DWP should issue statements at the end of the tax year to all those taxpayers who receive benefits, showing all benefits paid and whether or not they are taxable.

Many individuals receive state benefits during their lives. Some benefits are taxable, for example jobseekers allowance (JSA), while some are not taxable, for example the winter fuel allowance. The state pension is liable to taxation, but the Christmas bonus that is paid with it is not. Contributions-based employment and support allowance (ESA) is liable to tax, but income-related ESA is not.

At the end of the year it is difficult for a person to work out how much in taxable benefits they have received; award letters from the DWP are often unclear. Sometimes several benefits, some taxable and some not, may be included in one amount shown on a bank statement. As a result disputes over the amount of such payments can cause significant work for HMRC as well as distress for many people on low incomes.

Benefits

- **Taxpayers will have a greater understanding of which benefits are taxable**
- **Taxpayers will have the information to hand when either preparing a tax return or checking information provided by HMRC, such as PAYE 'P800' tax calculations**
- **Lower administrative costs for government as fewer taxpayers will need to make requests for separate information from DWP or to query their tax position with HMRC**

Every other employer and pension provider, no matter how small, is required to provide an end-of-year statement (P60) to those it pays, yet, in most circumstances, the DWP is not. (The exception being where a claimant is in receipt of taxable JSA or ESA at 5 April in a tax year but even in these circumstances the statement will only show the amount from the current claim.) We think this should change. The DWP should have all the information on their systems, linked to the individual's National Insurance number, but the provision of this basic information is not made available to the individual unless they request it. Such requests can meet with significant delays. It is time to provide this information automatically.

1C. The Government should review the possibility of the DWP operating PAYE on the state pension

Although for most people the state pension will be covered by their personal allowance (£10,600 for 2015/16), for some individuals it is not and this creates a tax liability. This is not collected monthly as would be the case for most PAYE income, but is collected in a lump sum after the end of the tax year. This can cause hardship and stress. It may also be unexpected since many people remain unaware that the state pension is taxable.

A further issue is that because no PAYE code is operated against the state pension, sometimes the state pension is not considered when allocating personal allowances to other sources of income. This can cause significant issues, particularly in the early years of receiving the state pension, when it is most likely to be overlooked by HMRC in the coding process. If proper PAYE procedures were operated on the state pension, significantly fewer tax underpayments would arise. These cause real distress and hardship to some pensioners as well as creating significant work for HMRC. In addition, the costs for HMRC of processing self assessment tax returns to collect small amounts of tax on the state pension are significant relative to the amount of tax being collected.

The case for this change has been strengthened by the announcement of the new 'freedom and choice in pensions' regime which will allow people to take much more flexible withdrawals from their pension plans. This is likely to lead to more individuals not having a consistent source of income (such as they may in the past have had when purchasing an annuity) against which to 'code out' and collect tax on the state pension.

Benefits

- **For those taxpayers whose state pension exceeds their personal allowance, tax would be deducted at source, meaning that fewer of them are required to complete self assessment tax returns, saving HMRC money**
- **By operating a PAYE code against the state pension, problems with coding which may be created as a result of people take advantage of pension freedoms from 6 April 2015 should be minimised**
- **Taxpayers would have a greater awareness that the state pension is taxable**

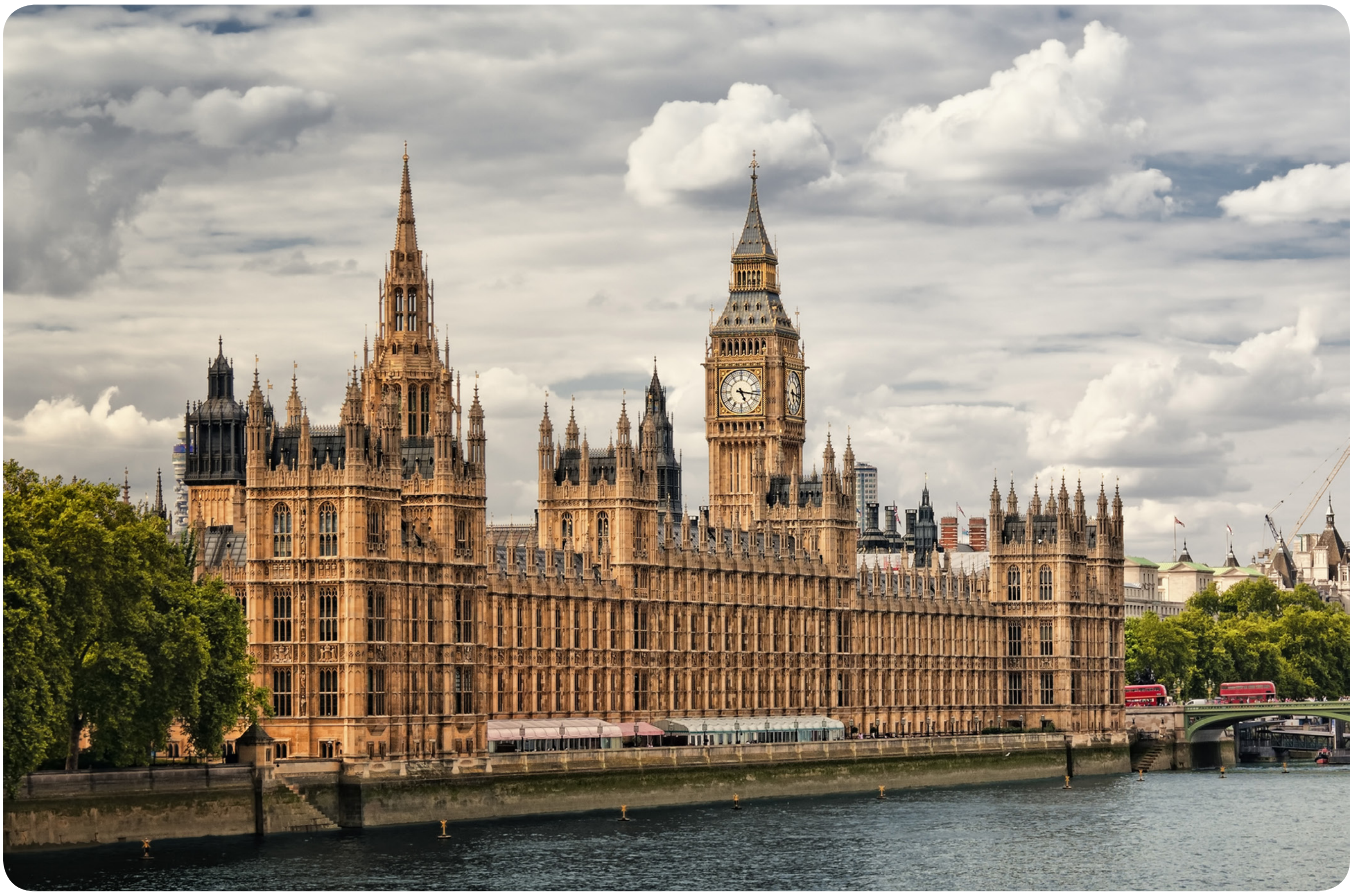
1D. The law and HMRC practice should provide a simpler mechanism for collecting small PAYE debts

Where individuals have a tax liability at the end of a tax year, often due to inadequacies in the PAYE system, there is no mechanism to collect the underpayment (if the taxpayer does not pay voluntarily or HMRC are unable to collect the underpayment from their current employment income by an adjustment to their Notice of Coding) without placing the taxpayer in self assessment. For many vulnerable people, completing a self assessment form is beyond their ability, requests to complete the form may be ignored and multiple penalties are then applied automatically.

Our recommendation is that one-off debts that are identified by P800 tax calculations (see Appendix 1) should be able to be assessed outside of the self assessment system, but with a full appeal mechanism. Further, any cases that are deemed necessary to be placed into the self assessment system should be prepopulated with figures that HMRC already have in their possession.

Benefits

- **Fewer self assessment tax returns would be needed, saving time and effort for taxpayers and HMRC alike**
- **Tax returns still deemed necessary would be simpler for the taxpayer to complete**
- **Liabilities would be paid faster since the self assessment process takes a long time**
- **HMRC would have fewer appeals against penalties imposed on vulnerable taxpayers**



2 Better communication and education on tax matters by government

The UK tax system is complicated. Some are able to pay professional advisers to navigate the system for them. But for everyone else it is crucial that they can find quickly and easily the information they need to comply with their tax obligations, and that the tax rules are set out in a form and language which can be easily understood by the ordinary taxpayer.

We believe there is an obligation on government not just to provide information on tax and tax credits but to proactively draw the attention of taxpayers to guidance relevant to them. This is true across the board but particularly applies in some of the areas picked out below. Additionally, all taxpayers would benefit from a basic grounding in how the tax system operates, provided as part of the school curriculum.

2A. Upgrade guidance provided on GOV.UK to make it clearer and more comprehensive

Bringing together all of the Government's information on one website is, in principle, a good idea: it encourages citizens to recognise that website as the prime source of information and thus reduces the opportunity for 'bogus' websites to mislead citizens.

Unfortunately when moving information from the HMRC website to GOV.UK, significant amounts of information have been omitted. While this may reduce the reading load for taxpayers, in places it over-simplifies the position leaving taxpayers in a vulnerable position where they rely on information on the website that has not tackled their individual circumstances without indicating that further guidance should be sought. This needs addressing.

Benefits

- **Citizens able to easily check areas of uncertainty, leading to greater compliance**

2B. Improve communication and application of special relief

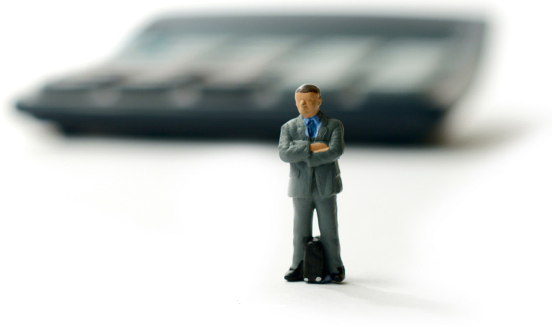
Special relief is a 'last opportunity' for HMRC to write off the debt of a taxpayer where collecting it would be 'unconscionable'. Such relief may be claimed where a taxpayer has failed to submit tax returns, determinations are raised by HMRC to collect the tax that they estimate is due, but the taxpayer later files the outstanding tax returns showing a liability lower than that determined by HMRC. Where the returns are filed outside the relevant time limits, HMRC are not required to correct the tax bills to the lower amounts and issue the related repayments to taxpayers. Thus, although the actual taxable income of the taxpayer is now known, and therefore also what their tax liability should be, the higher determination made by HMRC stands unless special relief is claimed and allowed.

It is very difficult for the unrepresented taxpayer to find any information about special relief – it is

Benefits

- **Less time would be wasted pursuing debts from the vulnerable that they are unable to pay**
- **Tax collected would more accurately reflect true tax liability**

challenging to find any mention of it online and even HMRC's call centre operators frequently do not acknowledge that it exists. Accordingly, many taxpayers end up paying more tax than would have been due had their tax bill been commensurate with their actual income. This is particularly unfair since on the opposite hand HMRC have powers to collect tax where they 'discover' that tax due for an earlier period was not assessed properly.



2C. Improve communication and guidance for tax credit claimants, especially where people stop being part of a couple

Where a couple who are required to make a joint tax credit claim end their relationship, they must report this change verbally or in writing to HMRC and they often go on to make separate single claims. The same types of issues arise where a person has recently ended a relationship and makes a claim for tax credits for the first time. Mistakes and confusion arise where the claimants believe their relationship has come to an end but other information leads HMRC to interpret the situation differently; for example, HMRC may decide that a joint claim should have continued and that the single claims are incorrect. This leads to overpayments on the single claims.

HMRC could improve their understanding of what causes errors in this scenario by undertaking detailed research into their existing Error and Fraud cases and using that analysis to do more to prevent those errors being made.

We recommend that HMRC introduce a process which involves having a conversation with people who are reporting that they have split-up and want to make a fresh claim. Rather than simply taking the notification as fact from the claimant, it would help enormously if the rules were clearly explained to the claimant at that point before the change is made. This would mean that errors in understanding or fact could be resolved before they give rise to errors in the tax credit award.

While tax credits are being phased out and replaced by Universal Credit, similar principles will apply to the provision of information around claims for the latter.

Benefits

- **Claimants able to comply more readily with the complex tax credit rules, leading to a reduction in errors and overpayments**

2D. Ensure that guidance around the new pensions regime includes adequate support on taxation issues

Prospective pensioners with low incomes and small pension pots could be left behind in the new 'freedom in pensions'[1] regime. Those with limited means often have complex circumstances and difficult decisions to make with what pension savings they have managed to muster, yet may not be able to pay for advice to ensure they maximise their benefits and minimise their potential tax liabilities.

We are concerned that the amount of help needed will be beyond the capacity of the government-funded 'Pension Wise' guidance service. People need to understand the way in which their pension withdrawals will be taxed, including how PAYE applies and whether or not this will lead to further self assessment reporting obligations and a further tax liability, or to an over-payment of tax and how long they will have to wait for a refund. They risk incurring substantial and unexpected tax charges on taking lump sums, which may not have arisen had they waited until a new tax year or spread the withdrawals. Even those who ask for a telephone or face-to-face meeting with one of the Pension Wise service providers[2] will find these last no more than 45 minutes.

Benefits

- More individuals making informed decisions about their pensions and consequently not 'forfeiting' part of that wealth unnecessarily
- Tax problems averted at the outset, rather than HMRC and voluntary and community sector organisations having to deal with a flood of queries down the line

We suggest that the Pension Wise service will need to be supplemented to provide the necessary tax support. For example, the charity Tax Help for Older People,[3] subject to suitable funding, may be able to take referrals of cases where pensioners with low means need assistance in considering the tax impacts of their pension options – but otherwise would not be able to afford that help. With auto-enrolment the number of people who retire with pension funds in addition to the state pension will increase, and with it the need for good advice on retirement.

2E. Expand education on finance and tax within society, particularly in schools

Financial education gets a brief mention under the heading of Citizenship in the new national curriculum, but the specific mention of tax which appeared in an early draft was removed. This is a shame. Tax plays a key role in determining a person's current and future financial resources. Unless citizens understand how tax revenue is generated and spent, they may feel disenfranchised from the system. Many people do not understand their payslips and that can lead to further problems such as tax debt.

Benefits

- Citizens will have a greater understanding of their tax obligations and the way in which tax revenue is used, encouraging compliance

[1] Those with personal pension savings will be able to make withdrawals as they choose, from the age of 55. Up to 25% of lump sum withdrawals will be tax-free but the remaining 75% will be taxable income.

[2] The Pensions Advisory Service is providing telephone support. Citizens Advice is providing face-to-face sessions.

[3] See www.taxvol.org.uk

3 Make paying tax as easy as possible for taxpayers with particular needs

Most people struggle to understand their responsibilities as regards taxation, or find it difficult to find the information they need to check their tax position. But some, because of age, disability or some other factor, need particular consideration. It is vital that the system is flexible and responsive, with alternatives to interacting online for those who are not computer-savvy. Sometimes people in this category will end up with their tax affairs in a mess before they seek help. The work of charity advisers in helping them get their affairs back on an even footing is crucial and must continue to be supported.

3A. HMRC's Needs Extra Support (NES) service should be promoted, expanded and similar practice extended to other Government Departments

The NES is a team within HMRC dedicated to assisting those taxpayers who need particular assistance in dealing with their tax affairs, because of illness, age, disability or other reasons. This can include those who are not able to engage fully with digital services. The NES service will help to file tax returns, and provide explanations to taxpayers on a face-to-face basis, if necessary. NES was rolled out in summer 2014 as HMRC's network of face-to-face enquiry centres was closed down.

Feedback on NES to date has been very good. The service seems to be working well, but awareness of it is low and HMRC need to work harder at publicising it. Also, the scope of the service is limited. It is aimed primarily at income tax and tax credits, though assistance might also be given for very basic capital gains tax, for example. It also does not currently extend to VAT or employer taxes. With increasing numbers of care and support employers (that is, people employing carers to look after them), it seems likely that many of them might require broader assistance than is currently available. We would like to see the service expanded to provide this.

Benefits

- **Taxpayers facing difficulties would be helped to comply with their tax affairs, resulting in less worry for them and fewer contacts with HMRC**
- **Other Departments might learn from HMRC experience/best practice in this area**

In particular, the DWP would benefit from having a team to support vulnerable claimants: this would provide the claimant with a better experience, ensuring they received promptly the benefits they were entitled to. In addition, it would relieve pressure on the DWP since these claimants would no longer be non-compliant and resources could be utilised more efficiently overall.

3B. Channels other than digital must be provided for citizens who require them

Channelling services and transactions online can save government money, and is the preferred option for many taxpayers. However, as a LITRG report[4] published in 2012 showed, there are some citizens who are not, and never will be, digitally engaged for a variety of reasons. The most common reason is age, but other significant factors, often combined with low income, include disability, learning difficulties, ethnic origin, location (digital 'not spots'), culture and language. The digitally excluded are likely to be disproportionately heavy users of government services. A study in 2012 by LITRG and three advice charities for the report mentioned above found that nearly half of those seeking help on tax and tax credit issues did not have access to a computer.

A 2013 tax tribunal case in which LITRG supported the successful appellants (*LH Bishop Electric Co Ltd & Others v HMRC Commissioners*) found that HMRC's requirement that VAT returns be filed online was discriminatory, and consequently gave legal underpinning to the requirement that practical alternatives to digital communications must be available. In response, the Government agreed to relax its rules in this area and allow telephone and paper filing in some cases. They must ensure that this is the case in other areas too. Alternatives to digital must be well publicised and easy to access. We understand that the Government intends to have an 'assisted digital' offering but the details of this service remain unclear: greater clarity and publicity are required.

Benefits

- **Taxpayers will remain engaged with Government and able to comply with their obligations**

3C. Continue/increase support for the tax charities to enable them to help those who cannot afford representation

Just because someone is on a low income it does not follow that their tax affairs are straightforward. Due to the complexity of the tax system, many people find themselves receiving unexpected tax bills that they simply cannot understand. Or they may be asked to complete forms that they find too complicated. In some cases, this inability to deal with their tax affairs arises because of a temporary crisis, for example family illness or bereavement, while for others declining health means that they can no longer deal with these matters.

While the NES service, mentioned at 3A above, is set up specifically to deal with vulnerable taxpayers, it does not deal with all taxes nor does it deal with taxpayers whose affairs have slipped into arrears although the taxpayer is not vulnerable. Further, where the taxpayer finds themself in conflict with HMRC, they have natural distrust of seeking help from a service that is part of the same department that they are in conflict with.

Benefits

- **The most vulnerable taxpayers are assisted to comply with their tax obligations and pay the correct amount of tax**
- **HMRC's resources are not diverted to this labour-intensive activity**

It is to assist these taxpayers – whose incomes are such that they cannot afford to pay a professional adviser – that the three tax charities exist. TaxAid and Tax Help for Older People offer free practical assistance for those on lower incomes through a combination of paid staff and the extensive use of volunteers, while LITRG works with government departments to improve systems and communications.

[4] http://www.litrg.org.uk/Resources/LITRG/Documents/2012/05/digital_exclusion_-_litrg_report.pdf

As well as receiving support from the tax profession, all three charities depend to a large extent on grants from government. Without the intervention of the charities many more vulnerable people would find themselves being pursued for tax debts that either do not exist or are excessive – or may miss out on a much-needed tax refund. Further, the work of the charities removes a significant amount of work from HMRC. It is vital that government, as well as the tax profession, continues to support the charities financially and that this support keeps up with the demand for their services.

Case Study 2
Barry

Barry received an unexpected tax demand for over £400. He was adamant that this liability had arisen because his two employers in the year had operated PAYE incorrectly. Having contacted HMRC on several occasions by phone and letter, HMRC accepted that around £300 was due to PAYE being operated incorrectly by his second employer. Barry was not satisfied and persisted to have HMRC review the position of the remaining £100.

Having obtained no satisfaction, and becoming increasingly stressed, he approached one of the tax charities for help. One letter from them to HMRC resulted in the further £100 being accepted as employer error and Barry's full tax bill being reduced to nil.

While these numbers may not seem large, they were very significant to Barry. Further, he had full records of payments made to him by his employers that he had sent to HMRC, but was still unable to bring the matter to a satisfactory conclusion without help. It is for taxpayers such as Barry that the tax charities perform such a vital service.

3D. Continue to seek opportunities to simplify the tax system for unrepresented taxpayers

Many more people are affected by inadequacies in the tax system affecting those on lower incomes. It is satisfying to observe how, over recent years, increased consultation has led to improved tax legislation and increased respect between HMRC and the tax profession. We welcome the opportunities to collaborate with HMRC on improving legislation, guidance and access for those we seek to represent and can only urge increased joint working in these areas.

For example, new rules are about to be introduced for the taxation of benefits made available to employees by reason of their employment. Following representations from LITRG, among others, these rules will be relaxed somewhat for carers and ministers of religion.

Benefits

- **Taxpayers find it easier to comply with the system**
- **Decreased ongoing cost for HMRC**

Some of the work of the Office of Tax Simplification (OTS) has been beneficial in identifying ways in which the system can be made to work better for people on low incomes; for example, the OTS's work around employee benefits and expenses. We hope the OTS will continue to work in areas of benefit to people on low incomes, and that government will continue to pay heed to its recommendations.

4 Improve how the tax and benefits systems work together

The tax system collects money for the state. The benefits system doles some of it out again. The ways in which the two systems interact are not always fair, logical or consistent.

There are big changes underway in the tax and benefits systems in the UK. Universal Credit (UC), which is being rolled out between 2013 and 2017, combines income-based JSA, income-related ESA, income support, child tax credit, working tax credit (WTC) and housing benefit into a single payment. Some tax and benefit powers are being devolved from Westminster. The number of people in self-employment is rising. In this environment it is more important than ever that policy-makers take an overview of the whole of the tax and benefits system and consider the impact of changes in one part on the rest of the system.

4A. Consider accompanying future increases in the income tax personal allowance with equivalent changes to the work allowance within Universal Credit

Since 2010 the Government has substantially raised the income tax personal allowance, increasing the take home pay of most people in work. However the benefits of this policy are not evenly spread. Obviously those not working, or earning less than the existing allowance, do not gain from an increase. In addition, low-income taxpayers who earn more than the personal allowance, but also receive means-tested benefits, gain significantly less than other basic rate taxpayers, because the tax saving from the raising of the threshold is offset by a diminution in their entitlement to benefit.

For example, an increase in the personal allowance of £1,000 means a 20% tax saving for a basic rate taxpayer £200. But if that taxpayer is claiming UC, their entitlement will be reduced by 65p for every £1 increase in their net income. So the actual saving for a taxpayer in this position will be just £70.

There is a different result though, if the taxpayer receives tax credits instead of UC. In this situation they benefit from the whole saving of £200, because tax credits entitlement is based on gross, before-tax, income, not net income.

Benefits

- **Increased incentives to work for low-paid workers**
- **Makes income tax changes more progressive in their impact**

The amount a UC claimant is allowed to earn before UC is reduced is called the ‘work allowance’. Current government policy is to freeze work allowances within UC until April 2018. If, as ministers state, ‘making work pay’ is a central objective of both personal allowance increases and the introduction of UC, they should consider whether the interaction between the two policies delivers incentives to work as effectively as it could. In particular we would ask them to consider whether the work allowance element of UC should be increased alongside any future increase in the personal allowance so that low-paid workers whose wages are topped up by UC benefit to the same extent as other basic rate taxpayers.

4B. Interactions between taxation and benefits must be considered fully by the Scottish and UK Governments before any further devolution takes place

Whatever their other merits, Smith Commission proposals to make income tax a shared tax between Westminster and Holyrood and to devolve some parts of the benefits system, are likely to bring further complexity to an already messy tax and benefit interaction process.

The tax treatment of state benefits varies. For example, contributions-based ESA is taxable whereas any income-related ESA is non-taxable. Entitlement to some benefits, for example UC, is dependent on after-tax income, so the tax status of other benefits is crucial. Any new benefits introduced by the Scottish Government will have to be assessed for their effects on tax and other benefits. Low-income individuals may not benefit greatly from reductions in income tax made by Holyrood because means-tested benefits – mostly reserved to Westminster – are based on net income. The Westminster Government's benefits cap may also come into play.

The importance of effective inter-governmental working has been recognised in both the Smith Commission Agreement and the recent UK Government Command Paper. It is important this extends to all interactions between welfare benefits and taxation, whether those are under the control of the UK government or a devolved administration or partly one and partly the other.

Given the increased powers that may be given to Wales and Northern Ireland, as well as areas in England, possibly, in the future it is crucial that proper protocols are put in place now.

Benefits

- **Policy intentions accurately reflected in reality (ie any new benefits or benefit increases will deliver intended financial benefits to the claimants)**
- **The tax treatment of any new benefit will be clearly understood**

4C. Review treatment of the self-employed under Universal Credit

The way the UC system operates creates a number of particular problems for self-employed people. Two of these in particular should be looked at again by government. The first is that the way in which self-employed people need to report their income for UC purposes is different from the way they need to report their income for tax purposes. This creates unnecessary duplication of work as well as confusion in the minds of the self-employed. We recommend this is reconsidered so that reporting is for UC and income tax purposes is as closely aligned as possible.

The second is that under UC a self-employed claimant can be worse off than an employed claimant doing a similar job and earning the same amount of money.

There are two main reasons for this:

1. Losses are not recognised. If a self-employed claimant's expenses exceed their receipts in a given month (perhaps because of an exceptional expense), they cannot set the difference against a profit for the next or any subsequent month.

Benefits

- **Lower administration costs for the self-employed**
- **Fairness - self-employed treated similarly to employed counterparts**

2. The impact of the 'Minimum Income Floor' (MIF) – an assumed level of earnings/profit that the Government use to calculate the level of UC payment when a self-employed person's earnings/profit are below that level.

The combination of the MIF with the disallowance of any carry-forward of trading losses means that when a business has to pay a large bill in a month when receipts are insufficient to cover the expense, the business will not only have to absorb the resulting loss but will suffer a wholly fictional uplift in its profits because of the MIF. Consequently, those whose businesses are seasonal or fluctuating in nature (such as farmers or workers in the tourist trade) will have some months during which they earn little but their profits for UC purposes are artificially inflated by the MIF, and others when their monthly receipts are high and for that reason they receive little or no UC.

In calculating the level of the MIF, no pension contributions are taken into account. This means a self-employed person will not get any relief for pension contributions where those contributions take them below the MIF. An employed person has no such restriction.

The UC rules should be amended so that self-employed people are in the same position as employed people to the extent that their tax, NIC and their pension contributions do not cause the MIF to be invoked, thus reducing their overall entitlement to state benefits. We also recommend that further consideration is given to changes to the MIF criteria so it is only invoked in cases where someone is not carrying on a trade with an expectation of profit or in a genuine, commercial way.

Case Study 3
Stephen and Tom

Stephen and Tom are twins. Their family situations are the same and both are self-employed, earning around £18,000 per year. Stephen earns his profits evenly over the year while Tom runs a coffee shop with profits arising in the months from April through to September, but breaking even or sustaining a loss for the other six months of the year. Their overall profits are the same, though.

Stephen's claim to UC will see him receive the same amount of extra cash every month.

Tom, though, is not so fortunate. Over the summer months, he receives no UC, because his profits are sufficiently high – perhaps around £4,000 per month. Over the course of the following six months, though, his profits are assumed to be at the level of the MIF, reducing the entitlement he would otherwise have had to UC. Over the course of the year, then, Tom is assumed for UC purposes to have earned significantly more than he actually has done – £24,000 PLUS six months of profits at the MIF.

Tom receives less UC than Stephen despite the fact their circumstances are almost identical. It is the seasonality of Tom's business that results in this unfair treatment.

5 A tax system that recognises the distinct challenges of self-employment and agency work

The number of self-employed individuals in the UK is growing. The Office for National Statistics reports[5] that:

- self-employment is at its highest level for at least 40 years, 4.6 million in total;
- much of the increase in employment figures since 2008 are new self-employments; and
- the self-employed now make up around 15% of the workforce.

The number of people in 'temp' or agency work is also increasing.

Some people are being 'encouraged' into self-employment and agency work as a route out of unemployment and to reduce reliance on state benefits. Self-employment may be an especially attractive option to some people with disabilities, if it provides them with the greater flexibility they need to be able to work. Making the system fairer and easier to navigate for these groups is essential.

5A. HMRC should make more flexible tax payment arrangements for the self-employed

A mechanism is needed for the self-employed to pay their tax liabilities flexibly, as and when they have cash available. Unlike employees, the self-employed do not usually receive regular amounts of cash – they depend on jobs being at a stage where payment may be requested, and then rely on prompt payment. It may be difficult to plan ahead for tax payments – a problem often felt especially by the newly self-employed, as demonstrated in our case study (below).

For general background on how the self-employed pay their tax liabilities, see Appendix 2. This also illustrates that HMRC already have power in primary legislation to develop flexible payment arrangements, so making such a change would only require investment by HMRC to adapt their systems to allow such flexibility.

Benefits

- **Assist the cash flow of self-employed people and their businesses, helping them succeed**
- **Reduction in tax debt and the number of people with payment difficulties**

[5] http://www.ons.gov.uk/ons/dcp171776_374941.pdf

Case Study 4
John

An individual who becomes self-employed takes some time to be fully incorporated into the payment system. John became self-employed from 1 June 2013. His profits are £2,000 per month. His first tax return relevant to his self-employment was that for 2013/14 which he had to lodge by 31 January 2015. On that date he also had to pay his tax for 2013/14 and make his first payment on account for 2014/15.

Based on profits of £2,000 per month, he had to pay tax and class 4 NIC based on £20,000 for 2013/14 (being profits for the ten months to 5 April 2014).

What came as a shock to him was that he also had to pay a further 50% of that liability as a payment on account for the tax year 2014/15. He therefore had a larger bill to pay then he might have expected, resulting in financial hardship and possibly debt accruing. Penalties are charged on late tax payments which can exacerbate the situation.

5B. A coherent and clear approach from government to the use of umbrella companies, bringing greater certainty for the low-paid

An 'umbrella company' provides contractors with a continuous contract of employment, turning the end client sites they are 'assigned' to into temporary workplaces. The cost of travel to those workplaces is therefore allowable against tax. Some other expenses may also be able to be claimed. Such arrangements are controversial – to some they are contrary to the spirit of the law but to others they are nothing more than 'straightforward' tax planning in response to the failure of the tax system to recognise expenses incurred by 'temps' and agency workers. This may explain why we have seen inconsistent and sometimes contradictory messages being sent out by policymakers on the desirability of such schemes.

Workers may be seduced by the prospect (genuine or otherwise) of increased pay. There is also evidence of employment agencies 'forcing' workers to work through umbrella companies. Either way, workers generally enter such arrangements without understanding the potential consequences: where HMRC deem that expenses have been claimed inappropriately, a significant tax bill may arise for the worker while the umbrella company generally escapes any sanctions. This can have devastating consequences for a low-paid worker, potentially placing them (and their family) in financial hardship.

Benefits

- **Low-paid workers will have certainty as to their take-home pay**
- **Unscrupulous umbrella companies will be forced out of business**

HMRC have targeted such arrangements in the past but seem to have been reluctant to engage with responsible umbrella companies on what is and is not compliant. The latest Budget announcement continues the piecemeal reforms. This uncertainty is deeply unhelpful to all concerned, particularly the (usually low-paid) workers. A more coherent joined-up approach is needed. In the longer run we think that there needs to be a 'fix' of the base rules that currently work against low-paid agency workers, for example by allowing low-paid agency workers to treat their assignment locations as temporary workplaces rather than fixed term appointments.

LITRG's report from November 2014, *'Travel expenses for the low-paid – time for a rethink?'*,[6] provides further background and recommendations on this topic.

[6] http://www.litrg.org.uk/Resources/LITRG/Documents/2014/11/LITRG%20PAYE%20report%20FINAL.pdf

6 Ensure limits and thresholds keep up with the cost of living

Unless the levels of allowances, reliefs and limits are increased along with inflation their value will decline in real terms. In some areas, legislation has put in place automatic rebasing by reference to a measure such as the retail prices index, however this is not the case everywhere. We highlight below one particular area where a relief is being seriously eroded.

This is by no means the only example, but some others have been addressed recently. For example, in the pensions arena the trivial commutation threshold was £18,000 for a few years, was increased to £30,000 from 2014 and the new pension rules from April 2015 will remove the threshold altogether, subject to certain conditions; the threshold at which individuals were required to make payments on account under the self assessment regime was left unchanged for over 10 years before being doubled in 2009.

The rent-a-room relief should be doubled and index-linked in future

Rent-a-room relief exempts from tax an amount of £4,250 that is obtained from renting out a room in one's own home. In addition, where the rent received exceeds that amount, you can choose to simply be taxed on the excess rather than identify all the relevant costs: in other words it simplifies administration for the homeowner.

Where the property is jointly owned, each owner has a maximum rent-a-room relief of £2,125.

The relief originally applied in 1992 to the first £3,250 of such income but was increased to £4,250 from 1997. Since 1997, rents have more than doubled in most parts of the country and the national average income from room rentals is £5,593 (£7,667 in London).[8] As rents have doubled, we suggest that the rent-a-room relief limit be doubled in a similar way and that provision be made in the legislation to review and uprate it each year in accordance with changes in average rents.

Benefits

- **Increased availability of rooms to rent**
- **Extra help for those struggling to pay their mortgage or trying to support a mortgage application with income from a lodger**
- **Fewer taxpayers needing to complete complex tax returns**

[8] See: http://www.spareroom.co.uk/raisetheroof/about/

Appendix 1: Further background information on the PAYE system

When the PAYE system was introduced in 1944, the workplace was very different from today. At that time, most married women did not work while many people remained with the same employer for long periods of time, often their full working life: upon retirement an employee would receive the state pension and, if they were fortunate, a workplace pension too. This is not the case now for most employees.

Current situation

PAYE usually operates efficiently where an individual has one source of employment income. HMRC issue a tax code to the employer that instructs them on the amount of tax to be collected from the employee's pay each pay day, based on their personal allowance and any other allowances (for example uniform allowances) or deductions (for example for benefits in kind provided by the employer). The employee can appeal against that code number if they disagree with it. For most of these employees, the correct amount of tax will be deducted during the year and no further action is necessary.

Where an individual has more than one source of employment income, or one source of employment income and one source of pension income, and so on, the system does not always operate so well. The employee may receive taxable state benefits for some or all of the tax year as well as benefits in kind from one or more employers. Each employment (or pension) needs to be allocated a code number and that means allocating personal allowances as well as various deductions between them. This allocation of allowances and deductions to different sources of income often leads to taxpayer confusion and incorrect amounts of tax being deducted. To add to the confusion, in some cases codes are issued to collect tax at only a specific tax rate in an attempt to restrict any incorrect deduction that would otherwise arise. While this may provide the correct result for the taxpayer it can be difficult for them to understand the process.

The unusual PAYE treatment of the state pension – collecting tax thereon by 'restricting' the individual's personal allowances against another PAYE source of income – adds a further layer of confusion.

For most taxpayers who are part of the PAYE system, there is no need for a self assessment tax return to be completed – instead HMRC perform a 'reconciliation' of the individual's tax affairs at the year end. If this reconciliation shows that the correct amount of tax has not been paid in the year, a P800 tax calculation is then issued to the taxpayer showing either tax underpaid during the year or that a tax refund is due.

There is no right of appeal against the P800 calculation: the taxpayer can raise queries, but if the tax is not paid on a 'voluntary' basis, after a time the 'debt' is referred for collection. If there is still no payment, the taxpayer is placed into the self assessment system, requiring them to complete a tax return for the relevant year. Should the taxpayer not complete the form, significant penalties are then applied automatically.

Our proposals in this area are designed to aid comprehension by the taxpayer, thus reducing their contacts with HMRC, while also providing them with a better opportunity of spotting mistakes early.

Appendix 2: details in relation to payment of tax liabilities by the self-employed

Currently the self-employed pay their tax and class 4 NIC in three parts:

- Two payments on account on 31 January in the year of assessment and 31 July following the year of assessment and
- A final balancing payment on 31 January following the tax year.

In addition, self-employed people pay class 2 NIC – normally monthly or quarterly, although this is to change so that the full payment will fall due on 31 January following the end of the tax year.

The Finance Act 2009 introduced primary legislation to allow taxpayers to spread the payment of their tax liabilities, but the administration for implementing this initiative appears to have been placed on the back burner. Indeed, this proposal fell somewhat short of the greater flexibility we hoped might be introduced as a result of HMRC's Consultation, *Modernising Power, Deterrents & Safeguards*[9] from which the following may be found in Chapter 4 when discussing other payments plans:

> "4.11 HMRC would welcome views on how to extend the principles behind these two schemes. The aim is to allow taxpayers to make flexible payments, so helping them with cashflow and preventing them getting into debt in the first place. This has to be balanced with ensuring that they pay enough, regularly enough, to keep their tax affairs up to date. It also has to protect the flow of funds to the Exchequer. Any scheme should reflect the principle that amounts deducted from an employee's wage are accounted for promptly. It must also be affordable for HMRC, both operationally and for changes to computer infrastructure.
>
> 4.12 It should be emphasised that any such payment options would be **voluntary**. Those businesses which prefer to pay under the current rules would still be able to do so."

While this appeared to imply such payment plans would only be available to businesses, we also hoped they would apply to individuals.

[9] http://www.rightsnet.org.uk/pdfs/HMRC_consultation_June_2007.pdf